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Special Assessment Districts

Loudoun County, Virginia

November 29, 2004

Special Assessment Districts
Loudoun County, Virginia

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Section 1

Memorandum on Policy Guidelines For Special Assessment Districts

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November 29, 2004

MEMORANDUM

To: Mark D. Adams
Paul N. Arnett
Ben Mays
John R. Roberts

From: David P. Rose
Courtney Rogers
James M. Traudt

RE: Policy Guidelines for Special Assessment Districts

C.C. Kirby M. Bowers

Davenport & Company LLC in our capacity as Financial Advisor to Loudoun County (the "County") has been asked to review the County's current criteria for establishment of special assessment districts as well as criteria of other jurisdictions and provide suggestions and observations regarding such criteria. As a prelude to our meetings with the Rating Agencies in January this memorandum addresses several general topics including:

- Existing County Policy
- Possible Modifications to County Policy
- Issues to Discuss with the Rating Agencies
- Considerations in Forming CDA's

We are sure there are other issues we may wish to consider. After reviewing this information and the supporting documents provided, though, we should be in a position to have a constructive conversation regarding these matters before visiting with the Rating Agencies in New York.

Policies Used by Other Jurisdictions

We have canvassed a number of jurisdictions in the region to identify policies that have been established where these types of districts have been utilized. Some jurisdictions with a history of utilizing special districts, such as Montgomery County, Maryland, apparently have no written policy while others have adopted detailed and comprehensive policies.

Anne Arundel County, Maryland developed a detailed policy on special assessment districts in 1998. This policy model has since been modified and adapted by both Prince William County, Virginia and by Hanover County, Virginia. Henrico County developed distinctly different and more generalized criteria for consideration of economic development incentives in 1999. These criteria have been used by Henrico County in considering projects but have not been formally adopted as County policy.

Each of these policies from these jurisdictions is included as an attachment to this document for County review.

Existing County Policy

The County's existing criteria (see Exhibit 1) sets forth three minimum requirements for the creation of a special assessment district. These include (i) a prohibition on the use of the County's full faith and credit or its moral obligation to support the debt, (ii) control by the County of any debt issuance, and (iii) the requirement that any debt issuance must be investment grade or provide for credit enhancement.

The County's policy provides flexibility when reviewing a proposed district in that the County may impose additional criteria on an ad hoc basis. Some fundamental criteria and other pertinent information that could assist the County's staff in reviewing a potential project, however, are absent. We would suggest that the County consider one of the following two options:

1) Make certain minimal modifications to the existing policy necessary for an appropriate review and analysis of the development proposal prior to submission of a petition; or

2) Adopt a more comprehensive policy similar to that developed in Anne Arundel County, Maryland and subsequently adapted by Prince William County, Virginia and by Hanover County, Virginia.

Minimal Modifications to Existing Policy

We would suggest that the County consider revising current criteria at a minimum to provide that any debt of a special assessment district not have an adverse affect on the County's debt capacity or credit rating, to require the developer to provide sufficient information to the County prior to submitting a petition to permit appropriate review and consideration of the project, and to require the developer to agree to fund the cost of County analysis of project feasibility.

Exhibit 2 shows the County's current policy modified to address these issues. This form of policy does not impose any specific limitations on the amount of debt that can be issued by a district or districts.

Adopt a Comprehensive Policy

Alternatively, the County could adopt a more comprehensive policy with respect to the creation of special assessment districts. By doing so, the County would provide developers with more detailed guidance as to information requirements, process, financial and credit limitations, and steps required prior to submitting a petition to the County Board. This type of policy also establishes specific limitations on debt issuance by a district or districts. Either this approach or the "Minimal Modifications" approach should be workable, though the Minimal Modifications approach does not impose debt limits on these types of bonds, and this may be of significance to the rating agencies.

Exhibit 3 is an example of a comprehensive policy that is based on the Anne Arundel policy with a variety of modifications including incorporating current Loudoun policy and specific debt limits.

- Exhibit 1: Existing Loudoun County Policy
- Exhibit 2: Modifications to the Existing Loudoun County Policy
- Exhibit 3: Comprehensive Policy Revisions

Other Policy Considerations – Ratings and Debt Capacity

The purpose of our meetings with the Rating Agencies is to determine with clarity how each will view the development of special assessment district financing in Loudoun County at the present time. While the Dulles Town Center project has proven successful, more recent proposals involve different types of projects and substantially more debt issuance.

We have included as attachments policy discussions prepared by Fitch Ratings and by Standard & Poors, though the Fitch Ratings piece is not directly on point.

It is our expectation that each of the Rating Agencies will offer a somewhat different perspective on how these districts may affect the County in the future, and how they will treat various aspects of them. There are a number of questions that it would be beneficial to have each agency address as well as issues which arise in the context of policy options discussed elsewhere in this memorandum.

1. **Overlapping Debt** – Will the debt be treated as overlapping debt for purposes of calculating the debt burden on County taxpayers? Under what circumstances, if any, will the debt be treated as direct debt of the County? Under what circumstances, if any, will the debt be treated as self-supporting debt? We expect that the answers to these questions will vary somewhat from agency to agency and that their ratio calculations will differ.

2. **Maximum Exposure** – Does the issuance of this type of debt raise credit concerns when it exceeds a particular percentage of direct County debt or a percentage of the tax base? What is that threshold? Anne Arundel limits this type of debt in the aggregate to 0.5% of the County's assessed value, Prince William to 0.75% of assessed value, and Hanover

County to 1.0% of assessed value. Anne Arundel also limits the debt to no more than 15% of all County tax supported debt, and to no more than 0.75% of the combined general fund revenue of the County and the districts.

3. **Ratio of Debt to Assessed Value of Property in the District** – Anne Arundel, Prince William and Hanover all restricted the amount of debt permitted to be issued based on the assessed value of the district at the time of financing and at buildout. All three jurisdictions limit the debt to 10% of the expected assessed value of property in the district at project completion. Anne Arundel and Prince William Counties limit debt relative to assessed value of the property in the district at the time of the financing to 33%, while Hanover County policy establishes a 40% limitation.

4. **Amortization** – Do deferred amortization structures raise specific credit concerns if debt repayment is heavily dependent on future growth?

5. **Type of Development** - How important is the distinction between a large residential development like the Greenvest proposal, a large commercial development like Dulles Town Center, a multi-use development, or a project like the Rt. 28 financing? How important is the distinction between improvements related to existing development and improvements related to the prospective development of vacant land?

6. **Policy Limitations –** Is a County policy creating specific limits on the amount of this type of financing, like the policies adopted for the County in general, more desirable from a rating perspective than a general policy without limitations?

Community Development Authorities – General Considerations in Forming Authorities

CDAs were designed to provide a method by which public and private entities can partner to finance and develop infrastructure and certain other improvements on a more timely basis than traditional methods allow. The creation of a CDA, however, is fairly complex and failure to take certain preliminary actions can cause difficulties in the later stages of the project. From the outset, the County should require that competent legal and finance professionals be involved to provide input on the project. Engaging professionals with prior experience in financings through CDA's is important as their participation will enhance the likelihood that the issues described below and others are addressed in a proper and timely manner. As noted below, certain actions that occur early in the process are difficult to amend later in the process.

Considerations in the Formation of CDA's

Zoning

- Is the property to included in the CDA currently zoned consistent with the proposed purpose of the CDA? Combining zoning approvals and formation of a CDA can be difficult.

Litigation

- Are there any potential litigation issues? If known, they should be resolved early. Should litigation arise later in the financing stage, significant delays can be expected and there would likely be difficulty in marketing bonds.

Identity of the Improvements

- All parties need to understand the improvements that are expected to be financed and the land to be included in the CDA. Failure to do so can prevent the financing of improvements using special assessments against some parcels that do not abut the improvements.

- Care also needs to be taken to document and make appropriate legislative findings with respect to the nature of the improvements and the benefits of those improvements to abutting landowners.

Petition/Ordinance

- The ordinance creating a CDA does not require great specificity. In fact, the inclusion of certain specifics may cause significant delays should there be any changes to the project or the financing. Amendments to an ordinance creating a CDA may trigger publication and public hearing requirements under Virginia law.

- The ordinance creating a CDA may require that the CDA enter into a memorandum of understanding with the County. Any requirements or parameters that the County desires to impose on the CDA can be set out in the memorandum of understanding. This agreement, unlike an ordinance, can be amended without the publication and public hearing requirements.

- The initial members of the CDA are required to be named in the creating ordinance. Thought should be given early as to who those members should be. Issues of conflicts and control should be discussed. This is particularly important if the County is to meet its goal of controlling the issuance of debt by the CDA.

- There are certain items that must be addressed in the creating ordinance, including, for example, whether the County will provide funds to the CDA and whether capitalized interest in excess of one year after completion of the project is allowed. Bond counsel often is required to determine after the formation of a CDA whether these and other actions are legally permissible. Bond counsel's participation in the formation stages allows them to identify issues such as these that should be addressed in the creating ordinance.

Exhibit 1

Existing Loudoun County Policy

EXHIBIT 1

Existing Loudoun County Policy

Criteria for Establishment of Special Assessment Districts

The following criteria are set forth as the minimum requirements that must be satisfied for the Board to lend its support to the creation of a special assessment district. As such, proposed districts that cannot meet these minimum requirements will have their requests for support rejected by the Board on the basis that it endangers the County's own credit worthiness in the financial markets. The Board takes this opportunity to emphasize that other considerations also may apply. In effect, these criteria are set forth only as the minimum standards for the establishment of a district. However, the ability to meet the criteria described below will carry considerable weight with the Board.

- The County shall not pledge either its full faith and credit or any moral obligation toward the repayment of principal and interest on any debt issued by the district.

- The Board will retain practical and legal control of any debt issued by the district.

- The Board will approve a district debt issuance only after it has been determined the issue can reasonably be expected to receive an investment grade rating from a nationally recognized statistical rating agency (i.e., Moody's or Standard and Poor's). If the natural rating is not investment grade, the County will require the district to acquire a credit enhancement (i.e., letter of credit, bond insurance, etc.).

Exhibit 2

Loudoun County Policy with Minimal Revisions

Modifications to the Existing Loudoun County Policy

The existing County policy is shown in italics below.

Criteria for Establishment of Special Assessment Districts

The following criteria are set forth as the minimum requirements that must be satisfied for the Board to lend its support to the creation of a special assessment district. As such, proposed districts that cannot meet these minimum requirements will have their requests for support rejected by the Board on the basis that it endangers the County's own credit worthiness in the financial markets. The Board takes this opportunity to emphasize that other considerations also may apply. In effect, these criteria are set forth only as the minimum standards for the establishment of a district. However, the ability to meet the criteria described below will carry considerable weight with the Board.

- *The County shall not pledge either its full faith and credit or any moral obligation toward the repayment of principal and interest on any debt issued by the district.*

- *The Board will retain practical and legal control of any debt issued by the district.*

- *The Board will approve a district debt issuance only after it has been determined the issue can reasonably be expected to receive an investment grade rating from a nationally recognized statistical rating agency (i.e., Moody's or Stand and Poor's). If the natural rating is not investment grade, the County will require the district to acquire a credit enhancement (i.e., letter of credit, bond insurance, etc.).*

- The special assessment district, both individually and when considered in the aggregate with previously approved special assessment districts, shall not have a negative impact on the County's debt capacity or credit rating.

- **Required Documentation**. The petitioners shall submit for County staff review, prior to petitioning the County Board of Supervisors for action, a plan of the proposed special assessment district. This submission must include as a minimum:

    - A draft of the special assessment district's petition to the County Board of Supervisors;
    - A map of district boundaries and properties served;
    - A general development plan of the district;
    - Proposed district infrastructure including probable cost;
    - A preliminary feasibility analysis showing project phasing, if applicable, and projected land absorption with the district;

- A schedule of proposed special assessment district financings and their purpose;
- A discussion of the special assessment district's proposed financing structure and how debt service is paid;
- The methodology for determining special assessments within the district; and,
- Background information on the developers and/or property owners like that found in an Offering Memorandum.

The petitioner shall respond to and incorporate changes to the draft petition requested by staff. Failure to incorporate changes will result in a staff recommendation against the creation of the special assessment district.

- **Project Review and Analysis.** A financial and land use assessment performed by the County or its agents must demonstrate that the District's proposed development, financial, and business plan is sound, and the proposed project or purpose for establishing a District is economically feasible and has a high likelihood of success. The analysis must confirm why establishing a District is superior to other financing mechanisms from a public interest perspective.

- **Petitioner to Pay County Costs.** The petitioner shall agree in writing in advance through a letter of intent to cover the County's costs for all legal, financial and engineering review and analysis and shall provide in the letter of intent a suitable guaranty for the payment of these costs. The County's estimated costs shall be itemized to show anticipated engineering, legal, financial, consultant and other fees

Exhibit 3

Comprehensive County Policy

<u>**EXHIBIT 3**</u>

Loudoun County – Comprehensive Policy Revisions

The existing County policy is shown in italics below.

Criteria for Establishment of Special Assessment Districts

The following criteria are set forth as the minimum requirements that must be satisfied for the Board to lend its support to the creation of a special assessment district. As such, proposed districts that cannot meet these minimum requirements will have their requests for support rejected by the Board on the basis that it endangers the County's own credit worthiness in the financial markets. The Board takes this opportunity to emphasize that other considerations also may apply. In effect, these criteria are set forth only as the minimum standards for the establishment of a district. However, the ability to meet the criteria described below will carry considerable weight with the Board.

Loudoun County (the "County") has determined that under certain circumstances, the creation of a Special Assessment District (a "District") can further the economic development/quality growth management/redevelopment goals of the County. Of equal importance to the County is that no public monies be at risk. These guidelines are designed to insure that the County goals are met.

1. **Limited to Projects which Advance County's Plans.** The proposed project or purpose for establishing a District must advance the County's comprehensive plan and provide greater benefit to the ultimate property owners utilizing the proposed facilities.

2. **Description of Project and District Petition.** The petitioners shall submit for County staff review, prior to petitioning the County Board of Supervisors for action, a plan of the proposed District. This submission must include as a minimum:

- A draft of the special assessment district's petition to the County Board of Supervisors;
- A map of district boundaries and properties served;
- A general development plan of the district;
- Proposed district infrastructure including probable cost;
- A preliminary feasibility analysis showing project phasing, if applicable, and projected land absorption with the district;
- A schedule of proposed special assessment district financings and their purpose;
- A discussion of the special assessment district's proposed financing structure and how debt service is paid;

- The methodology for determining special assessments within the district; and,
- Background information on the developers and/or property owners like that found in an Offering Memorandum.

The petitioner shall respond to and incorporate changes to the draft petition requested by staff. Failure to incorporate changes will result in a staff recommendation against the creation of the special assessment district.

An application fee of $______ is payable at the time the petition is submitted. If the petition results in the creation of a District, an additional $______ administrative fee is due.

3. **Consistency with County Planning Documents.** The petitioner must demonstrate that the project or purpose for establishing the District is consistent with the Comprehensive Plan, Zoning Ordinance, and if applicable, the Capital Improvement Program.

4. **Impact on County Credit Rating.** The District, either individually or when considered in aggregate with previously approved Districts, shall not have a negative impact on the County's debt capacity or credit rating. Total aggregate outstanding debt of all Districts shall not exceed ______% of the total assessed value of taxable property within the County; nor represent more than _____% of the outstanding tax supported debt. The debt service on District financings should represent no more than _____% of the total of general fund operating revenue and District revenue. Maturities of District debt shall be limited to no more than ___ years and the average life of any individual issue shall be no longer than ___% of the longest maturity, or ___% of the average life of the assets being financed based on engineering estimates.

   It is the intent of the County that this debt be self-supporting. Debt is deemed self-supporting when sufficient revenue is generated for at least three consecutive years to pay all of the required debt payments, and during those three years the taxable assessable base would have to have a stable or growing and varied base to produce the revenues.

5. **Due Diligence.** A due diligence investigation performed by the County or its agents must confirm information regarding the reputation of the developers, property owners, and/or underwriting team, and the adequacy of the developer's or property owner's financial resources to sustain the project's proposed financing.

6. **Project Review and Analysis.** A financial and land use assessment performed by the County or its agents must demonstrate that the District's proposed development, financial, and business plan is sound, and the proposed project or purpose for establishing a District is economically feasible and has a high likelihood of success. The analysis must confirm why establishing a District is superior to other financing mechanisms from a public interest perspective.

7. **Petitioner to Pay County Costs.** The petitioner shall agree in writing in advance through a letter of intent to cover the County's costs for all legal, financial and engineering review and analysis and shall provide in the letter of intent a suitable guaranty for the payment of these costs. The County's estimated costs shall be itemized to show anticipated engineering, legal, financial, consultant and other fees.

8. **Agreements.** The County will require the petitioner, prior to submission of the petition to the County Board of Supervisors, to provide the following information:

   - Protections for the benefit of the County with respect to repayment of debt, incorporation, and annexation;
   - Protections for the benefit of individual lot owners within the District's boundaries with respect to foreclosure and other collection actions should their respective assessment be paid or is current; and
   - That, if the District requests the County to levy a special tax on its property owners, the District will pay the County for the costs to levy and collect the special tax and any other ongoing administrative costs of the County.

9. **Credit Requirements.** The debt obligations are issued by the District to finance or refinance infrastructure of the project:

   - *The Board will retain practical and legal control of any debt issued by the district.*
   - *The Board will approve a district debt issuance only after it has been determined the issue can reasonably be expected to receive an investment grade rating from a nationally recognized statistical rating agency (i.e., Moody's or Stand and Poor's). If the natural rating is not investment grade, the County will require the district to acquire a credit enhancement (i.e., letter of credit, bond insurance, etc.).*
   - The District's outstanding debt obligations as compared to the appraised value of property or adjusted appraised value if partial development has occurred within District boundaries as if the infrastructure being financed was in-place shall not exceed _____% at the time the bonds are issued, and shall not exceed ____% once the development is complete, based on reasonable projections.

10. **Requirement for Approved Financing Plan.** The ordinance creating the District shall include a provision requiring the District to submit a financing plan to the County for approval by the __________ prior to the issuance of any District obligations. Such financing plan shall include details specific to the financing proposed to be undertaken, including, but not limited to more complete and detailed information of those applicable items required under Paragraph 2 above.

11. **No Liability to County**. *The County shall not pledge either its full faith and credit or any moral obligation toward the repayment of principal and interest on any debt issued by the district.* The project must pose no direct or indirect liability to the County, and the developer and/or District must provide the type and level of surety acceptable to the

County to protect the County from actions or inactions of the District as specified in the letter of intent at time of petition. All documents relating to the project shall reflect the fact that the County has no financial liability for present or future improvements connected with the project whether or not contemplated by the ordinance creating the District or as that ordinance may be amended.

12. **Development Agreement.** Covenants acceptable to the County shall be set forth in a development or acquisition agreement executed in connection with the issuance of the debt which among other things, will incorporate the salient commitments of the District development proposed.

13. **Annual Review.** These guidelines shall be reviewed at least annually, and changes to the guidelines proposed in conjunction with the review by the County.

Section 2

Standard & Poors: Public Finance Criteria: Special-Purpose Districts

Publication date: 12-Nov-2002
Reprinted from RatingsDirect

Public Finance Criteria: Special-Purpose Districts

Credit Analysts: David G Hitchcock, New York (1) 212-438-2022; Colleen Woodell, New York (1) 212-438-2118

Service System Districts

Special-purpose service system districts are political subdivisions created to provide economic development or related services to an area—residential, commercial, or industrial—that levy an on-going ad valorem tax levy or charge a specific user fee to fund service operations. Special-purpose districts may be located within an incorporated municipality, but most are in unincorporated, developing areas. Special-purpose districts provide a wide variety of services; the most common type provides public utility services such as water, sewers, and drainage. Special-purpose districts also fund hospitals, fire protection, parks, cemeteries, soil conservation, roads, and other services.

Special-purpose district debt obligations may carry:

- Revenue pledges of system operations;
- Property tax pledges; or
- A combination of the two.

Special-purpose districts, which are not fully developed, are generally characterized by the involvement of a developer or developers, who are trying to activate residential, commercial, or industrial construction. Mature districts may experience little, if any, additional development. Based on the varying size and complexity of special-purpose districts, management requirements differ. In some cases, a full-time administrator or manager and staff are responsible for district operations; smaller districts may employ management companies or a part-time administration. Almost all special-purpose districts give ultimate decision-making power to a board of directors that is independently elected or appointed by another governmental entity or entities. The special fee or tax that comprises the special-purpose district's revenue source is often tied to an identifiable service or improvement. For example, a flood control project or sewer hookup would be an effective use of a special-purpose service system district, because all property owners would benefit equally. With special assessment districts, on the other hand, the tax that property owners pay is only in proportion to their perceived benefit from a capital improvement. When the special-purpose service system district encompasses a new residential development, the fees, charges, or taxes sometimes are capitalized into home costs. The ultimate purchasers of the residential properties will bear these costs. If not capitalized, such payments can be made in a lump sum or over a specific time period—usually 10 years.

The time frame forces Standard & Poor's to focus on the surrounding economy and its vulnerability to swings in the local business and economic cycle. In areas greatly affected by cyclical downturns, significant declines may occur in special district collections. Standard & Poor's has seen cases where collections faltered badly in recessions, returning to more acceptable levels only after district management intensified collection efforts. At the same time and in the same general area, collections on general property taxes hardly fluctuated from historical norms.

Because of the large development risk in startup situations, or in highly concentrated developments, special considerations apply.

Financial and Operational Data

With respect to financial data, Standard & Poor's prefers to review a historical three-year period plus the current year's budget. Coverage is usually calculated with and without tax revenues to indicate relevance and proportional importance to the entire revenue structure. Balance sheet items are carefully considered for the equity aspect. Planning is the key to management's effectiveness in producing desired goals.

Standard & Poor's would like to be apprised of all plans through reports and/or meetings with management. A Standard & Poor's field trip to the site is recommended. Indices for residential, commercial, and industrial development in the district and area are essential. Where possible, development projections should be supplied for several years, permitting evaluation of future potential.

Standard & Poor's prefers to review the trends from several vantage points: price, volume, and absorption rate. Per-square-foot costs are probably the easiest to compare area-wide. A profile of the potential purchaser is helpful, especially in the residential sector, where prospective homebuyers' income qualifications must be sufficient to close purchases and support all levels of taxation.

In certain instances, a developer may be required to make an up-front contribution to a project. The sale of special district bonds is often an aid in financing the developer's obligation. Offering the lower municipal rate is key to the financing agreement. The district's acceptance of a note from the developer can be recognized only if the legal covenants are fairly strong, with a bank line or an LOC backing.

Fee and Tax Structures

Two items essential to debt retirement are fee and tax structure. They should permit capturing of fees and taxes sufficient to satisfy operating and capital needs. Taxes will be considered along with the regular property-tax burden on other debt outstanding. Fees will be considered as to the reliability of their collection and their adequacy in covering all unprovided needs from special district taxes. A dependence on developer fees, which may be of a one-time nature, to meet debt service can be a negative credit factor.

The emphasis on timeliness of payment is important. A debt service reserve fund is helpful in covering risk. Fundamental considerations of economic strength and the success of the tax structure are critical. How often fees and taxes can be adjusted, and how quickly, is also given great weight in Standard & Poor's analysis. In many cases, the special-purpose district is limited to a certain millage rate, a certain annual increase, or a combination of both. This limit could have profound implications if ad valorem growth declines from previous levels or a major developer-taxpayer files for bankruptcy protection. Relative affordability remains key in this area. Experience proves that the project as a whole must be financially feasible to potential purchasers in the area.

Permanent residential communities are viewed more favorably by Standard & Poor's than other developments, based on a notion that is supported in financial performance. People who reside in an area year-round are more attentive to tax bills and are more likely to pay on time. For many reasons, seasonal vacation-home owners may not as prompt with tax payments, special fees, and charges. Mixed communities fare better where there is a substantial full-time population. Usually, a minimum of 500 full-time residents is important to qualify for an investment-grade rating on special service system district bonds, although peak seasonal populations are examined carefully. If a district is in a portion of an existing city, it would be viewed more favorably than a new area in an unincorporated area. The latter disadvantage can be mitigated by proximity to employment and recreational opportunities. With good statistics to support the argument, a strong case can be made that a district is part of, and not separate from, the prospects of the surrounding area.

The individual developer's ability to point to successfully completed projects is a plus in any special district consideration. A developer should be willing to supply some documented confirmation of its ability to bring a project on line and within budget. Also helpful is a description of a developer's financings and a history of mortgage payments. In general, the more information presented substantiating the strength of the district, the less room there is for speculation and uncertainty about the focus and growth of the district in the future.

Tax Increment Bonds

Tax increment financing, sometimes called tax allocation bonds, have been issued in a majority of states, although California redevelopment agencies continue to account for the bulk of national volume. Tax increment financing attempts to repay debt solely from those taxes generated from the increase in property value in a district after a redevelopment project has begun. As such, it creates no additional tax burden on district taxpayers, but merely represents a reallocation of tax revenues that would otherwise flow to pre-existing taxing entities in favor of a redevelopment agency that issues debt. Tax revenues from pre-existing property valuations in a tax increment project area continue to flow through to the underlying taxing entities as before; only the taxes allocated to the increase in property values flow to the redevelopment agency.

Tax increment bonds benefit from several favorable structural elements compared to other special district debt. Unlike special assessment and Mello-Roos bonds, no additional tax burden is created for taxpayers, and tax collection rates are generally less of a concern, unless project area tax payments are concentrated in a few taxpayers. In addition, while undeveloped land in a special assessment or Mello-Roos district creates high debt burdens, undeveloped land in a tax increment district is generally a favorable factor, since revenues will increase to the extent new development occurs and taxable property values grow. In contrast, revenues do not grow for special assessment or Mello-Roos debt because those taxes are not based on land value, although development may lead to more favorable value to debt ratios for those types of districts.

The main credit risk for tax increment districts is that tax rates and the pace of private development in a project area lie outside the control of the redevelopment agency issuing the debt. Actual tax rates generating the tax are set by the underlying taxing entities—cities, counties, school, park districts, and others-- that set their tax rates without consideration of the needs of the redevelopment agency. Changes in state tax law, or assessment practices, can dramatically influence tax increment revenue.

A typical investment-grade tax increment district already generates sufficient revenues to cover future maximum annual debt service at the time of the sale of bonds, a feature sometimes called "coverage in the ground". However, the experience of southern California during the 1990s shows that many different factors can subsequently reduce tax increment revenues. Some of the common pitfalls of these bonds include volatility in commercial real estate values during an economic downturn, particularly for warehouses and hotel properties, widespread tax appeals that can overwhelm county assessment offices, a residential real estate bust, construction risk on projected projects, state tax law changes, plant closures, concentration in a few taxpayers, purchase or foreclosure of land by tax exempt entities, and a high tax increment volatility ratio for recently formed project areas.

Background

The mechanics of capturing assessed valuation growth are straightforward. The redevelopment agency delineates a project area and declares a base year. The existing base assessed valuation is taxed as before by each overlapping taxing entity covering a portion of the project area. Overall tax rates may vary within the project area, depending on the boundaries of the underlying tax entities, and the sum of their tax rates. Additional assessed valuation added to the tax rolls in future years is taxed at the same tax rate as the base valuation. However, the tax revenue attributed to the new incremental assessed valuation is remitted to the redevelopment agency and pledged to pay debt service. Sometimes a state may reimburse an agency for revenues lost as a result of property tax exemptions. The redevelopment agency has no taxing power and depends on the tax rates set by independent agencies and by private construction activity for its revenues. A redevelopment agency can increase pledged revenues only by encouraging growth through its redevelopment activities. Nevertheless, new development does not guarantee high revenues, because adverse tax rate changes or subsequent restrictive legislation could affect revenues.

Project area analysis

Standard & Poor’s analysis focuses first on general economic factors that may affect the economic growth of the project area, such as a municipality’s population, employment, and income level. Building permits may indicate overall city construction trends. Nonetheless, the general character of a city is not necessarily a barometer of the conditions within a localized project area. In this respect, a site visit may help give credence to rapidly improving economic conditions that are not reflected in assessed valuation numbers. One way to get a description of a new project area is to read the redevelopment agency’s plan, which outlines prior economic conditions and project objectives.

Taxpayer concentration

One weakness of many project areas is their small size, leading to taxpayer concentration. Standard & Poor’s has no size limit on investment-grade rated project areas. Generally, smaller districts will have weaker credit characteristics and, thus, lower ratings. A larger project area, generally one of over 150 acres, is usually more diverse and more creditworthy. Standard & Poor’s analyzes taxpayer concentration by comparing top taxpayer assessed valuation to project area incremental value—not project area total value—because revenues rise or fall based on incremental valuation. It is not uncommon to see each of the top five taxpayers accounting for more than 100% of project area incremental valuation in newly formed project areas, even though top taxpayers may appear deceptively diverse when compared to total project area assessed valuation. Generally, Standard & Poor's requests the assessed valuations of the top 10 taxpayers. It is not atypical for 40% or more of the incremental tax base to be held by the top five taxpayers, based on the relatively small size of most project areas. Taxpayers may not appear overly concentrated when considered collectively, yet the assessed valuation may still consist largely of just one shopping mall or condominium development. Market factors also can swing the value of such shops and homes together as a result of their common location and function. Districts concentrated in a particular type of property may have vulnerabilities also, even if they are diverse by taxpayer. If payment of debt service is wholly dependent on just a few taxpayers making their tax payments, it may be difficult to achieve an investment-grade rating unless those taxpayers are themselves rated. Even in this case, the property should be highly essential to the taxpayer to get the benefit of the credit rating assigned to the taxpayer. An example would be an important generating plant of a rated investor owned utility.

Assessment practices that may at first appear to "guarantee" tax collections have been shown through experience to not always be reliable. A financially strong company can still remit smaller-than-expected tax payments by appealing its assessment (which can take three years or longer to resolve), not rebuilding after a fire, or delaying initial construction.

Historical assessed valuation growth

Standard & Poor's prefers to examine at least four years of project area assessed values. One of the virtues of tax allocation bonds is the typically high growth rate of assessed valuation within most new project areas. However, a recent base year may cause deceptive percentage rises in incremental assessed valuation because of the small early-year increments. Total project area assessed valuation may be a more meaningful indicator of growth trends. In a few states, fire, demolition, or conversion to tax-exempt property may be used to decrease the frozen base assessment—increasing incremental assessed value—without new construction.

Future assessment growth

An important indicator of future assessment growth is the acreage available for new development. A fully developed area, with no redevelopment potential, effectively limits the possibility of assessed valuation growth. However, project areas with large undeveloped land areas are not assured of attaining growth. Construction strikes, changes in market conditions, or higher interest rates can suddenly cancel or delay even the most promising development.

Construction risk, when present, is such a risk factor that most investment grade-rated tax allocation bonds already demonstrate coverage of maximum annual debt service by historical tax revenues (Standard & Poor's will consider next year's tax levy an "historical" revenue if it is based on the current assessor's assessment roll and the current tax levy), although exceptions have been made when debt service could be covered with only limited amount of future growth that seems especially likely. Historical coverage of debt service alone, however, does not necessarily guarantee an investment-grade rating.

Secured/unsecured property
Standard & Poor's looks at the type of property, using categories such as personal and real property. In California, the categories used most often are secured and unsecured property. Essentially, unsecured property is movable; secured property is not. A high proportion of unsecured property (about 30% or more) is a negative rating factor. For example, a high concentration of one project area's assessed valuation was its computer equipment, which was moved to another of a plant and outside a project area. As a result, tax revenues could no longer cover debt service. Airplanes, or cars at a dealership, may also constitute another major moveable property value.

Taxpayer delinquency
Major taxpayer assessment appeals can delay collection of revenues for up to three years. In addition, all foreclosure action stops if a taxpayer declares bankruptcy, since federal bankruptcy law supersedes local tax collection law.

Management
Policy control of a redevelopment agency usually lies in the city council, with an executive director responsible for implementation. The agency holds broad authority to acquire, develop, and administer property, as well as eminent domain powers. Often a major portion of tax allocation bond proceeds are used to acquire and consolidate parcels of land. Questions for management may encompass additional debt plans, unusual features of the redevelopment plan, and the land use breakdown when the plan is completed.

Legal considerations
Standard & Poor's analysis of the legal structure of a tax allocation bond focuses on the security pledge, flow of funds, debt service reserve fund, and provisions governing the issuance of additional parity debt. The flow of funds is usually simple. Tax increment pays debt service, makes up debt service reserve deficiencies, and then revenues are released for any purpose. Lack of a fully funded reserve is viewed as a negative rating factor in view of the low debt service coverage of most tax increment bonds.

Additional debt issuance is likely over the life of a bond issue. Tests for additional bonds requiring 1.25x coverage of maximum annual debt service by historical revenues, or revenues to be realized as a result of the most recent finalized assessment rolls, are considered a typical provision. However, stricter additional bonds tests allowing coverage of debt service in the event of further top taxpayer delinquencies may enhance credit quality. Provisions allowing adjustments to revenues based on construction in progress severely weaken the test. The strength of the additional bonds test is examined in relation to the number of taxpayers excess cash flow could cover, in the event of delinquencies, assuming a redevelopment agency bonded out to the limit of its additional bonds test. Thus, no one additional bonds test or coverage level can guarantee a specific rating. Many more established diverse districts have issued debt with less than a 1.25x additional bonds test without a negative impact on their credit rating as their tax volatility ratio declined and their taxpayer concentration diminished. Standard & Poor's weighs a more permissive test against taxpayer diversity, historical and projected growth trends in assessed valuation, the nature of such growth, and the need and likelihood for additional debt issuance. On the other hand, higher debt service coverage and stronger additional bonds tests may offset weaknesses in district economic diversity.

Aside from an issue's legal structure, Standard & Poor's evaluates tax increment authorization laws and litigation. Standard & Poor's examines all new state authorizing legislation for potential problems. Litigation frequently accompanies tax allocation issues, especially in states newly authorizing such financing, because public entities losing the tax revenues have an incentive to sue. Taxpayers and overlapping units often contest the constitutional validity of new tax allocation legislation; counties may wish to postpone the loss of revenues, and taxpayers may want to delay eminent domain proceedings.

Some tax increment bonds also have a pledge of a city's GO. Standard & Poor's will rate such double-barreled securities based on the higher of the GO or tax increment rating, since both are pledged to debt repayment.

Financial operations
Primarily, financial factors include an analysis of fluctuating tax rates, delinquent collection rates (for the project area, not the city), and historical debt service coverage. No specified level of coverage leads to a particular rating, since taxpayer concentration or legal factors may be much more important. When a particular weakness is identified, it is useful to check coverage sensitivity to such vulnerabilities. For example, if an issuer experiences poor property tax collection, coverage levels and additional bonds tests can be raised to compensate. The lower of the additional bonds test coverage level, or current revenue coverage of maximum annual debt service, is used for analysis. Projected coverage based on construction growth is not always reliable, but worth considering.

Various mathematical considerations concerning the ratio of base to total assessed valuation also may affect the volatility of the revenue stream in the event assessed valuation declines. In general, the smaller a district's base valuation is compared to its total valuation, the lower the revenue volatility.

Cumulative tax limits
Project areas in California are subject to a cumulative cap on tax increment that can be collected from a project area over the life of the project area. Sometimes, higher-than-projected tax increment can cause the cap to be reached before final bond maturity. If this appears to be a significant possibility, Standard & Poor's would prefer a covenant by the redevelopment agency to annually review the total amount of tax revenues remaining and to escrow revenues or not accept tax monies if it would cause the tax limit to expire before final bond maturity.

Special Assessment Bonds
Special assessment bonds are secured by a special tax, such as a street front-footage assessment, which is levied in relation to the benefit a property receives from an improvement. As a consequence, the tax is not based on the actual value of a property and debt burdens, as a percent of the market value of a parcel, can vary greatly one parcel to another. Since each taxpayers' tax payments are usually fixed and can not be raised to cover the delinquency of any other taxpayer, credit analysis must focus on the exposure to the weakest properties, even if overall average property value to debt ratios are strong districtwide.

In particular, special assessments on undeveloped land may create burdensome tax payments for those properties. Undeveloped land typically carries property value-to-debt ratios of 3:1 or less, while developed properties are generally closer to 20:1. Standard & Poor's expects investment grade special assessment bonds to be able to at least withstand two separate sensitivity analyses: (1) a permanent tax delinquency by the two largest special assessment taxpayers; and (2) a permanent delinquency by all special assessment taxpayers with under a 5:1 value-to-overlapping debt ratio.

Sources of money to cover potential delinquencies may come from reserve funds, an ability to raise taxes to a limited degree, overcollateralization of tax payments, back-up support from a city's general fund (often found in Arizona), cross-collateralization with other special districts, a senior/subordinate bond structure, or other revenue sources.

Special assessment bonds have proven very popular in growing areas such as California and Florida, where existing residents may be reluctant to pay for infrastructure improvements in new housing developments. However, special assessment financing is used throughout many areas of the country.

Examples of projects funded by special assessment bonds include water and sewer lines, lighting improvements, roadways, and sidewalks.

Financing special assessment projects
The special assessment process is often quite simple. In most cases, property owners in a limited area, or their local representatives, petition for the creation of a special assessment district. A project is specified that will directly benefit property owners within the district and be paid for by fees or assessments based on a measurement related to the benefit, such as street frontage or square footage owned. Bonds are sold to finance the project(s), and security is provided by the assessments.

Most improvements provided by special assessment bond financing are related to local infrastructure, although bonds have been sold to finance parking lots, landscaping, and public parks. These improvements benefit district property owners by improving the quality of their neighborhood and contributing to greater property values.

Usually, bonds are used only for the construction of the project and not for maintenance. Often, the municipality will absorb the maintenance cost, since the project generally is tied into a citywide system, such as water and sewer services.

Standard & Poor's believes that special assessment bonds may have some speculative elements. However, these speculative elements can be mitigated through such factors as:

- An ability to raise assessment tax rates to a limited degree;
- The existence of excess cash flow from reserve earnings;
- Particularly strong value-to-lien ratios;
- A lien on parity with or ahead of ad valorem taxes;
- Legal protections within the bond structure;
- Economic incentives for timely payment of special assessment obligations; and
- Low risk associated with the particular project.

Sometimes special assessment districts without excess cash flow, or with significant undeveloped land in their districts, can be carved into senior/ subordinated structures to make a portion of their debt investment-grade

Major criteria considerations
Following are some major criteria considerations for special assessment bonds. However, undeveloped districts carry additional development risk.

Project essentiality. The project's degree of importance to assessment payers is an influential factor in determining whether those benefiting from the project will pay their assessment. Most special assessment issues should be able to meet the test of essentiality, since bonds are commonly used for water, sewer, and street improvements. However, less essential projects, such as parks or landscaping, may be looked upon negatively.

Project risk. Generally, projects using a known technology and developed by experienced personnel mitigate Standard & Poor's concerns.

District makeup and economic base. A district largely undeveloped or concentrated in one type of industry or assessment base is viewed negatively. A special assessment district tied to a stable and diversified economic base is desirable. The effects of employment levels, wealth indicators, and regional trends on payment of assessments are evaluated.

Assessment basis. The basis for establishing assessments should be objective and equitable.

Method of assessment collection. A collection system tied to ad valorem taxes is preferred. Standard & Poor’s also may regard incentives for early payment and disincentives for late payment as positive features. For example, penalties for late payment and discounts for early payment may be worthwhile, depending on their effect on cash flows.

Value-to-debt ratios. High property value-to-debt ratios, preferably above 7:1 for investment-grade ratings, increase the likelihood of making assessment payments on a timely basis. Also, the marketability of property in the district points to added security if properties must be sold as a result of foreclosure or bankruptcy. Value to lien ratios must be examined on a parcel by parcel basis for top taxpayers, since tax levies can not typically be raised on the strong taxpayers to pay for the weak, rendering overall district value to lien ratios problematical in many cases. Standard & Poor’s prefers value to lien ratios using county or city assessed valuation, although independent appraisal reports may be evaluated also if deemed reasonable.

Lien position. A lien on parity with or ahead of ad valorem taxes is desirable. Preferably, the general property tax bill should be combined on the same statement as the special assessment tax bill to help collection rates.

Treatment of property sales. Liens should remain in place upon transfer of property or be extinguished by an immediate acceleration of all outstanding, current, and future special assessments on the property.

Foreclosure/bankruptcy provisions. Assessment collections should not be hindered by foreclosure, bankruptcy, or sales of tax certificates or tax deeds. Action should be taken on a timely basis to ensure that sufficient funds are available to make scheduled debt service payments. The marketability of property is also a concern here; a detailed property market study would help to determine the demand for property in foreclosure or bankruptcy proceedings. Ability to carry foreclosures on an accelerated basis is favorable.

Clear right to issue. Public hearings and a deadline for discussion are necessary, within legal requirements, so that there are no legal challenges possible once bonds are offered.

Term and redemption of bonds. The debt service schedule is usually flat or declining over time and should be within the useful life of the project and improvements. Most special assessment bonds have maturities of 15 years or less.

Debt service reserve. A reserve fund or other security feature that provides for payment of debt service is essential in the event that assessments are not received on a timely basis. The amount of the debt service reserve and the way that it is funded are important, because funds to cover any revenue shortfall are expected to be available at all times. Additionally, debt service reserve investments should be in securities with a high degree of safety and liquidity.

Cash flow runs. Sensitivity tests that demonstrate the bond structure's strength in the event of taxpayer nonpayment, prepayment, and anticipated payment are necessary in evaluating the ability of the bond structure to withstand unexpected events. Assumptions regarding interest rates on the bonds and debt service reserve investments should be tested as well. Standard & Poor's normally expects some excess cash flow available to cover a default by at least the top taxpayer, unless the top taxpayer has itself been rated by Standard & Poor's. In some cases, Standard & Poor's commercial mortgage group can evaluate the credit quality of an individual development for assessment bond purposes and the rating can be based on a single taxpayer or retail development. Usually, however, Standard & Poor's requests information determining the maximum number of taxpayer delinquencies a district can handle before defaulting and compares this to the concentration of the top taxpayers. Where extremely high taxpayer diversity exists, such as in fully developed residential districts, the debt service reserve alone may be able to cover the permanent loss of the top five taxpayers, mitigating excess cash flow needs.

Active monitoring. Active administration and monitoring by a municipal entity is an important enhancement of the structure of the credit. A municipal entity—often the county, city, municipal utility or redevelopment authority—should be charged with the responsibility of administering the assessment collection process and successful completion of the project.

California's Mello-Roos Districts

The different types of taxes allowed under the Mello-Roos Act raise varying credit quality considerations, but certain key concerns are common to all Mello-Roos bonds. Probably the greatest credit risks occur in the district's initial phases, when the taxpayer base is concentrated and debt-to-assessed value (loan-to-value) ratios are high because land may be owned by a few developers and largely undeveloped (see Undeveloped Special Districts). As development occurs, credit quality should improve to the extent that ownership becomes more diverse, and loan-to-value ratios decrease. Upon a refunding, several years after a district's creation, credit quality could be vastly improved. Even relatively undeveloped land could receive a favorable initial rating if the area is characterized by numerous taxpayers, good loan-to-value ratios, and flexibility to cover taxpayer defaults by raising tax rates.

Easy to implement

Mello-Roos financing is attractive for two reasons. First, unlike special assessment bonds, it allows the financing of general purpose projects, such as police stations, which may be outside Mello-Roos district boundaries. However, all projects by law must have a useful life of more than five years or provide additional services previously unavailable. A second attraction is Mello-Roos districts' easy implementation in growing areas because of the enabling act's usage of ambiguities in Article XIII. Article XIII's voter approval requirement for new debt refers to "qualified"' voters without specifying who is "qualified" when no voters reside in a district. The Mello-Roos Act declares district landowners to be the voters when 12 or fewer voters reside in a Mello-Roos district, an interpretation that could be subject to future legal challenge if there are actual residents present.

Because districts may be formed in any size or shape, even from noncontiguous parcels, it should be relatively easy to form and obtain voter approval of a Mello-Roos district in undeveloped or industrial areas. Overlapping Mello-Roos districts may be formed by different legislative bodies offering different services. A legislative body in California, such as a city council, board of education, or county board of supervisors, can form a Mello-Roos district as long as it is authorized to perform the services being provided.

A legislative body may initiate proceedings upon petition by 10% of landowners or voters in a proposed district or by written request of two legislative members. The legislative body has 90 days to adopt a resolution that sets district boundaries, type and apportionment of proposed taxes, necessary new facilities to be provided, amount of proposed debt, and date for a public hearing that must be held within 60 days. An election is held 90–180 days after the public hearing. If fewer than 12 registered voters reside in a district, the vote is accomplished by assigning one vote per acre of land owned. Practically speaking, district boundaries can be drawn to guarantee that fewer than 12 voters reside in a district or that residents support district formation.

Any type of tax may be imposed in a Mello-Roos district, as long as the tax burden can be evaluated at the time of voter approval and is not levied against property values. In addition, legislation requires maximum potential taxes imposed for bonds sold in 1993 and thereafter to provide no more than 1.10x annual coverage of bond debt service at the maximum permitted tax rate. Taxes can be designed to mimic property taxes closely, even if by law they can't be imposed solely on the value of a property. For example, a district could tax the number of homes, street frontage, or number of acres. Even a per capita tax can be imposed, using taxes that are fixed or fluctuate up to a cap. To date, an acreage tax or an equivalent dwelling unit tax seem to be the most popular form of taxation. Taxes may kick in on different dates, and maximum permitted tax rates often escalate 2% per year to accommodate an increasing debt service schedule. Generally, undeveloped land (usually owned by developers) is not taxed, or taxed very little, while future homeowners support actual debt service. As long as bonds are outstanding, the tax cannot be repealed.

The many possible Mello-Roos tax structures create different risks depending on their structure. However, all districts have some features in common. The strongest districts have economic diversity, with numerous taxpayers and high value-to-loan ratios, and levy a well-designed tax that covers a broad tax base. Such a district could receive a favorable credit rating if the existing tax base can produce favorable coverage of future maximum annual debt service, and an additional bonds test locks the coverage in. The best additional bonds tests use the maximum permitted tax rate on the existing tax base to calculate a minimum coverage requirement on future maximum annual debt service. Too often, weak additional bonds tests require only an appraiser's report, subject to possible error, estimating a certain minimum value-to-lien ratio. Additional bonds tests based on building permits granted are weaker than tests based solely on revenues from owner occupied homes.

Concentration of district taxpayers is a particular risk for small or start-up districts. If payment of debt service depends on payments from a few taxpayers, there are obvious vulnerabilities. Apart from the normal cash flow problems caused by delinquency of a major taxpayer, a federal bankruptcy law filing by a taxpayer can indefinitely forestall local foreclosure action. Taxpayer concentration is particularly important, because most districts were originally formed by a few developers holding undeveloped land. The ability to raise tax rates may mitigate concentration risk if additional levies could cover delinquencies by major taxpayers. However, 1992 reform legislation capped maximum tax rates to no more than 1.10x coverage of debt service.

Sometimes maximum tax rates are designed to increase a certain percent every year to match an increasing debt service schedule. If so, inflation assumptions should be carefully scrutinized in such a case to ensure that homeowners would not be subject to possibly onerous taxes in later years and the tax burden still needs to be reasonable in the later years for a creditworthy bond issue.

Many types of taxes can be imposed and pledged to debt service; therefore, Standard & Poor's will examine each Mello-Roos bond issue on a case-by-case basis. Major rating considerations include:

- Surrounding economic characteristics,
- The nature of the development and the developer's track record,
- Tax-to-property value relationships,
- Restrictions on additional debt,
- Existence of overlapping districts,
- Project feasibility,
- Nature and diversity of items taxed and the tax structure,
- Cash flow timing and sensitivity to taxpayer defaults,
- County assessment and collection practices, and
- The property value added by the funded project.

Certain types of development are subject to more risks than others. For example, multifamily housing projects are more cyclical in their sales patterns than single-family homes, and preleasing may mitigate office building construction risk.

In general, the nature of development risk may introduce varying degrees of speculative characteristics to undeveloped districts owned by just a few developers. However, credit quality may improve rapidly as development occurs, and homes or commercial development are sold off. The ability to raise tax rates, while limited by reform llegislation, still provides Mello-Roos districts with potentially better credit quality characteristics than most special assessment districts, with which they share many similarities. A number of formerly speculative "raw land" districts now have developed to the point where their credit quality is quite favorable. However, investors still need to do their homework to make sure that structural factors, such as the additional bonds test, and fundamental economic factors would support a high rating.

Undeveloped Special Districts

Standard & Poor's has extended its criteria for special districts, Mello-Roos (Community Facility District), and special assessment districts to include noninvestment-grade debt and more clearly delineate the types of development risk involved in largely undeveloped special districts.

Such distinctions are important, since the nature of real estate and construction risk can vary widely among undeveloped districts. Special districts with debt rated below investment-grade display an even greater degree of unique variety than more highly rated debt. Nevertheless, certain commonly found situations would compare in terms of creditworthiness (see box). Fundamentally, creditworthiness for special districts depends on prospects for strong real estate values, reasonable debt levels, and taxpayer diversity.

Legal covenants

A 500-unit housing development may or may not be placed in the investment-grade category, depending on the particulars of local real estate conditions. Strong structural legal protections regarding taxpayer foreclosure, debt service coverage, or debt service reserves cannot, in and of themselves, raise a rating into the investment-grade category unless favorable real estate conditions exist. Legal covenants providing meaningful bondholder protection must lock in the economic benefits of a strong tax base against future issuer actions, such as additional debt dilution or poor tax collection procedures, but the tax base must exist first.

Thus, a Mello-Roos bond with a weak tax base will not necessarily be able to improve its bond rating with strong structural legal covenant protections, since there is little to protect. On the other hand, a Mello-Roos district with a strong tax base may be prevented from obtaining a higher bond rating by weak structural protections.

If development occurs, creditworthiness may improve dramatically in an undeveloped district. However, weak legal protections, written in at the time of bond sale, may limit upside rating potential even if the tax base develops as planned. Investors still need to examine legal covenants closely in almost all situations, even before development occurs.

In particular, a fully funded debt service reserve may buy an issuer some time during periods of heavy foreclosures, but cannot cover against ultimate losses. Other legal provisions of importance include:

- Maximum permitted tax rates;
- Additional bonds tests; and
- The timing of foreclosures and tax rate changes.

There are also key legal differences between unlimited tax special districts, Mello-Roos debt, and special assessment debt, although undeveloped districts share similar real estate development risk. Special district and Mello-Roos bonds usually have the flexibility to raise tax rates to cover a taxpayer foreclosure loss. This is a key strength of special district and Mello-Roos debt over special assessment bonds. Special assessment bonds usually have just 1x coverage of annual debt service by yearly special assessments and lack any ability to raise tax rates. In such cases, the bond may be only as strong as the ability to receive ultimate repayment from the weakest property taxed.

Exceptions exist. Sometimes debt service reserve earnings can cover foreclosure losses of the top taxpayers if the top taxpayers are small, compared with the total tax base. Another exception occurs in Florida, where the state allows the special assessment tax rate to be raised in many cases, up to a limited amount. This feature makes many Florida special assessment bonds resemble Mello-Roos bonds—a positive feature. Some Florida special assessment bonds are rated in the 'A' rating category.

Land appraisals

Appraisals of vacant land by private consultants may be problematic. The difficulty is that they are based only on a value at a point in time, and built on a set of assumptions that developers will follow the expected use of the land. If plans do not materialize as anticipated, or new landowners change their expected use of the land, actual values for vacant land could change appreciably. For this reason, private appraisals of raw land can often be considered unreliable. Standard & Poor's looks at the reasonableness of appraisal assumptions and sometimes may discount appraisal conclusions. There are wide distinctions between different types of development districts, and investors more than ever need to distinguish the strong credits from the weak. In particular, investors may want to determine if legal features could preclude a bond from ever moving into the investment-grade categories. The accompanying table, while it does not cover every case, should provide helpful guidelines. Some positive factors, such as debt service coverage, can offset other negative factors, such as taxpayer concentration.

Information Requirements

To rate the debt of special-purpose service system districts, Standard & Poor's needs information aside from the standard GO requirements. The following itemized list, although tailored specifically to sewer and water districts, generally covers additional data needed for all special-purpose district ratings:

- A field trip to the district site is recommended.
- A copy of the bond resolution and/or bond ordinance, and all leases and contract agreements with other districts.
- A copy of all applicable statutes concerning organization, powers of the governing board, and debt issuance authority.
- Outside agencies with the power to limit revenue sources or control development should be discussed.
- Legal limits on the district's revenue sources should be explained.
- A description of all insurance carried on the facilities, including general liability insurance.
- A description of management, including the number of board members and the method of election or appointment, and the role of the leading administrative person(s). There should be a description of experience and common interests of board members, staff and leading developers. If the district is operated by a management company, some information about the firm's experience is necessary.
- A certified independent audit for at least one year is required. Up to five years of audits should be supplied when they are available, along with the previous year's accountant's management letter, when it exists relative to the audits. In cases where the special district financial reports do not conform to GAAP, Standard & Poor's will evaluate the reliability of the reports on a case-by-case basis
- Where there is a budget, it should be supplied..
- Information on local school districts and other overlapping governmental units must be provided, including future debt-issuance plans, and, for school districts, enrollment trends and plant capacity.
- Procedures for the annexation of additional area by the district and for the annexation of the district by incorporated municipalities also are required.
- Details of past new construction by year (at least one year and for five years, if available), amount, and type (residential, commercial, or industrial) are necessary.
- A development plan and engineering report detailing water and sewer trunk lines in existence and planned, the amount of land developed and the amount remaining suitable for development, and a summary of the type of contributions required of developers are needed. The latter would include roads, lateral sewer and water lines, and, in some rare cases, direct contributions to school construction. The adequacy of trunk lines for additional planned hookups and the expected life of the lines also should be treated.

Common Service System District Characteristics

- Double-barreled security (taxes/water-sewer revenues).
- Higher-than-average debt ratios per capita and to market value.
- High level of debt service to budget (frequently exceeding 20%).
- Debt issues in anticipation of future growth, rather than in response to development.
- Longer average debt maturity.
- Frequently supported by debt service reserve funds.

Administration

- Established with small constituency.
- Revenue stream dependent on demand for, and supply of, services or commodity (sewer/water).
- Short-lived operating track records (many start-up situations).
- Administration and management are frequently minimally staffed and inexperienced or contracted to outside parties.
- Rate setting and budget adjustment may not be timely.
- Single-purpose nature of the district may make the issuer more prone to bankruptcy filing.
- Subject to annexation.

Economic

- Frequently rural, or developing suburban.
- Rapid growth characteristics.
- Debt usually issued primarily in early stages of development.
- Major taxpayers often dominated by developers and speculators.
- Small size, frequently accompanied by lack of diversification.

Financial

- Tax collections and service charges subject to volatility.
- Little or no operating history.
- Accounting and financial reporting variations (hybrid of government enterprise accounting).
- Increased importance of financial and capital planning and feasibility studies.

Tax Increment Bond Volatility Ratio

The mathematical formula used to compute incremental tax revenues does not treat all project areas equally on a general decline in assessed values. Tax increment project areas containing a small amount of incremental valuation in relation to their total assessed value will show greater volatility revenues. This is often the case for recently formed project areas. Thus, two project areas, with the same amount of total assessed value, can have unequal loss of tax increment revenues, even when losing the same amount of total assessed value.

Standard & Poor's uses a revenue volatility ratio to highlight the speed at which revenues can fall in the event assessed values decline. The ratio consists of the project area's base assessment to total assessment. This ratio can serve as a proxy for the speed with which tax increment revenues will rise or fall in the event of a fluctuation in assessed value. Standard & Poor's expresses the volatility ratio of base assessment to total assessment as a decimal fraction between 1.0 and 0.0. A higher number represents more volatility. In other words, revenues will rise or fall more rapidly with a small change in project area assessed valuation when the ratio is high. The ratio is incorporated as part of Standard & Poor's rating process.

The ratio serves as a convenient flag for the most vulnerable districts in times of real estate decline. Most of the tax allocation bonds that experienced troubles during California's real estate downturn of the 1990s had high volatility ratios.

On the other hand, a high volatility ratio can also cause a quick increase in revenues and coverage in the event of even modest assessed value increases.

In the example, project areas A and B have the same assessed value and tax allocation coverage, but would respond very differently to a 10% decline in overall project area AV. Project area A has a low base-to-total assessed value volatility ratio of 0.2, while Project area B displays higher revenue volatility with a change in assessed valuation, with a volatility ratio of 0.8. Project area A, which is older and has a smaller base valuation, suffers a much smaller decline in coverage, from 2.0x to 1.75x if total assessed valuation declined 10%. Project area B's debt service coverage falls from 2.0x to 1.0x with the same percentage decline in assessed value because it was more recently formed and has a high base valuation relative to total assessed valuation.

The volatility ratio is specific to each project area, and is independent of the amount of debt issued by a project area.

One alternative way to look at this volatility ratio is to examine its inverse. The inverse represents the percentage that total project area assessed valuation must fall to produce zero tax increment revenues. Thus, a high volatility ratio of 0.8 means total assessed value would have to fall 20% before there would be no more tax increment revenues.

Examples of Different Base to Total Project Area Assessed Valuations

Different volatility with same initial coverage and assessed valuation

	Low volatility Project area A	**High volatility Project area B**
Total assessed value	$500 million	$500 million
Base increment	$100 million	$400 million
Incremental assessed value	$400 million	$100 million
Tax rate	1.00%	1.00%
Pledged revenues	$4 million	$1 million
Maximum annual debt service	$2 million	$500,000
Coverage	2.0x	2.0x
If project assessed value fell 10%		
Project assessed valuation	$450 million	$450 million
Incremental assessed value	$350 million	$50 million
Pledged revenues	$3.5 million	$500,000
Coverage	1.75x	1.00x
Base assessed value to total value volatility ratio	0.2	0.8

Ranking Characteristics of Special Tax Districts

'A'	'District is close to fully developed (80% or better); Diverse taxpayer base; Strong economic location; Good coverage of maximum annual debt service; Fully funded reserve; Strong legal protections regarding additional debt issuance,, and prompt property foreclosures.
'BBB'	Mostly developed (around 70%); Some taxpayer diversity; Good prospects for economic growth; Only adequate coverage of maximum annual debt service (1.10x), or a weaker additional bonds tests; Fully funded reserve. OR District is fully developed (100% built-out); Concentrated tax base (40% of taxes paid by the top five taxpayers); Legal provisions prohibit additional debt issuance unless the maximum permissible tax rate can provide at least 1.20x coverage of future maximum annual debt service. (High concentration can be offset by high coverage); Good economic location. OR Only partly developed; Strong economic location; High land values (10:1 assessed value to lien ratio and up); Very diverse taxpayer ownership (top taxpayer is no more than 4% of total taxes); Very strong legal protections regarding additional debt dilution; Good coverage of maximum annual debt service (1.20x +); Mandated quick action on property foreclosures; and fully funded debt service reserve.
"BB"	Vacant district upon which construction has just begun (land is graded or very partially developed); Appraised market value to lien ratio,, using conservative assumptions, ranges from 7:1 to 3:1 or better; Highway access to nearby employment center; Good residential density in surrounding neighborhoods; Strong track record for the developers; Some legal covenant protection on additional debt issuance or coverage margins; a few developers may own the majority of the district during construction. OR A major diverse ownership shopping center is planned with pre-leasing in place; Good surrounding residential density; Good legal covenant protection; No major competition nearby; Appraised value to lien of 3:1 or better. OR Strong multifamily development under way in a very densely populated neighborhood; Good legal covenant protection; Appraised value of 3:1 or better. OR Very small residential district,, but already built-out and sold to individual homeowners (only 30 homes,, already built); Good legal covenant protection.
'B'	Completely undeveloped district with one or two developers as owners; planned for single-family development in a more remote location; 3:1 value to lien ratio; Half-funded debt service reserve. OR District is primarily an office building(s) already built without a tenant; Good value to lien ratio; More remote location or lower population density. OR Weaker multifamily development already under construction in a more remote location or lower population density neighborhood.
'CCC'	Proposed commercial construction with prospects for a glut of competing properties. OR Proposed single-family development with high debt (2:1 value to lien or worse); No debt service reserve; Raw land in a remote location.

Section 3

Fitch Ratings:
Tax Allocation/Tax Increment
Bond Financing Guidelines

Tax Supported
Special Report

Tax Allocation/Tax Increment Bond Financing Guidelines

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■ Summary

Tax increment financing (TIF) is used by redevelopment and development agencies and other similar entities (collectively referred to here as redevelopment agencies) to finance the cost of infrastructure improvements within their respective project areas. These infrastructure improvements, in turn, facilitate development or redevelopment of real estate within the area by private developers. The tax base growth resulting from the development generates incremental tax revenues to pay debt service on the agencies' bonds, known also as tax allocation bonds (TABs). Taxes paid on the original property tax base continue to flow to overlapping municipal jurisdictions.

In some jurisdictions, agencies share a percentage of their revenues with overlapping municipalities, either pursuant to interlocal agreements or state law requirements. Also, some states require agencies to use a percentage of the incremental tax revenues for specified purposes. For example, in California, 20% of incremental tax revenues must be used to support low- and moderate-income housing.

Redevelopment agencies have no independent taxing powers. Rather, they rely on incremental taxes, net of the aforementioned pass-throughs and set-asides as their only available revenue source. Therefore, redevelopment agencies and holders of their bonds rely on sustained positive economic performance within the project area.

TABs are issued to benefit one or more project areas and often cover a geographically small area. As a result, bond security often relies on revenue that is moderately to heavily dependent on a few taxpayers. This concentration, along with the limited nature of tax increment revenues, causes Fitch's analysis of TABs to emphasize the development already completed or projects under way within the defined area.

Other key rating considerations in evaluating this debt type are:
- Project area characteristics.
- Redevelopment plan and implementation.
- Agency management and taxing procedures.
- Project area and surrounding economic factors.
- Tax revenue set-asides and pass-throughs.
- Debt service coverage and debt-related covenants.

February 3, 2004

Project Area

A major factor contributing to the success of TIF is the size and composition of the project area. Particularly important are the area's economic diversity, development under way, and potential for future growth. Tax revenues from an area composed overwhelmingly of any one type of project may be volatile. For example, during periods of economic declines, an area dominated by commercial businesses may experience weak performance, causing tax delinquencies, tenant closings, surges in vacancies, reduced rents, and, eventually, declining property values. As a result, incremental tax revenues would decline. Even without economic declines, a predominantly commercial area may suffer from construction of competing enterprises nearby. In contrast, a project area composed of a mix of commercial, residential, and industrial properties likely would experience a smaller proportional decrease in incremental tax revenues.

In addition to analyzing the mix of properties within the area, Fitch will evaluate the major taxpayers. When an area is dominated by a few large taxpayers, the success or failure of their projects will have a major effect on bondholder security. Under these circumstances, Fitch will closely scrutinize such taxpayers' history in the area and the relative importance of the specific facilities to those taxpayers.

The amount of land within the project area available for development may also affect the generation of incremental tax revenues. Limited amounts of available land restrict growth potential. Largely developed areas must rely on property reuse and redevelopment (i.e. substituting one property use for another) for assessed value and consequent property tax growth. Required zoning changes may be procedurally and politically more difficult. Also, parcels available outside of the project area may be more attractive or less costly. Therefore, Fitch will consider both the amount and characteristics of land within and outside the project area available for development, as well as the land's current zoning and relative desirability.

Location of the project area also is considered. Access to major transportation corridors, including public transit, will affect the viability of most projects. Completed similar facilities located in proximity to the project area also may affect a project's success.

Tax payment history of property owners within the project area is evaluated. Collections rates assumed in projections should reflect historical tax collection rates, including realistic delinquency expectations. Disputes and assessment appeal revisions further compromise available incremental revenues. Consequently, projections should include conservative loss estimates if appeals are pending. The historical rate and success of taxpayer appeals will also be evaluated.

Redevelopment Plan

As mentioned, in Fitch's view, the most important component of debt service coverage is incremental revenues generated by development already complete or substantially complete. Therefore, Fitch will only consider assignment of an investment-grade rating when incremental tax revenues to be generated by such projects cover debt service at least 1.0 time (x). Although Fitch may credit tax revenues expected from projects already under construction or those permitted and financed, higher coverage is required to offset completion risk and other uncertainties.

Fitch also considers future planned projects and other growth potential to determine the appropriate rating level within the investment-grade categories. Examination of both initial and updated development plans will indicate whether the agency has established realistic goals and whether those goals fit within broader economic development plans for the overall region, as well as those of overlapping municipalities. Such analysis also will be part of Fitch's assessment of the agency management team and its relationship with overlapping municipalities.

Fitch also evaluates the development agreement itself. Generally, the agreement is between the developer and agency but also may include the primary and overlapping municipalities. Clear assignment and delineation of responsibilities within the agreement evidences commitment to executing the plan by the parties involved. Detailed descriptions in the agreement can avert disputes that could otherwise delay or impair development.

The developer's experience and financial commitment levels also are rating considerations. Most often, large development companies use legally and financially separate subsidiaries for each project, and previous experience of affiliates may not be directly indicative of the success of projects under consideration. Furthermore, financially sound parent companies generally are legally separate from the developer subsidiaries, resulting in no deep-pocket to absorb additional costs.

■ Agency Management and Taxing Procedures

A development project area's success will be influenced by management and administration of the development overall, as well as the tax collection processes. The development plan's implementation must be carefully monitored by the responsible agency. Also, support of the plan by overlapping municipalities enhances credit quality. When elected officials of overlapping municipalities are represented on the agency's board, coordination and cooperation is more likely. The agency staff's ability to oversee the development and respond to ongoing challenges and changes also is critical to success. Experience and the agency's track record in economic and real estate development also is considered.

Management of tax assessment and collection procedures is a rating factor, although Fitch recognizes that redevelopment agencies generally have no responsibility for and are unable to impact these procedures. Historical evidence of prompt property reassessments following market condition changes and sales enables more rapid collection of the incremental tax revenues available to an agency. Likewise, orderly tax collections and prompt pursuit of delinquent taxpayers will contribute to realization of projected revenues. The status, level, and timing of tax assessment appeals are also reviewed.

Foreclosure options also impact bondholder security. Accelerated foreclosure minimizes the period during which real estate taxes are not paid. In addition, upon sale of the property, delinquent taxes are subtracted from the sale price. Judicial foreclosure is one remedy that enables municipalities to sell properties subject to tax liens more quickly than they can under standard foreclosure laws. Consequently, Fitch will examine local and state real property foreclosure laws. Agency covenants to pursue expedited foreclosures are viewed positively.

■ Project Area Economics

Economic conditions within the project area and the region help Fitch evaluate whether growth is likely and the degree that is reasonable to expect. A project area's location along a growth and development corridor also is likely to affect the redevelopment agency's ability to attract and retain redevelopment. Projects on the fringe of regional development fare poorly in economic downturns and could remain vacant or result in property value appeals and losses. Commercial businesses and residents often opt to move closer to proven economic centers as those land values become more affordable. Further distanced alternatives, then, become less attractive for new development. Competing project areas and facilities outside the project area but within the region will also be assessed.

In addition to regional economic considerations, Fitch evaluates the economy of overlapping municipalities in a manner similar to the way general and other tax-supported debt is analyzed. Common credit factors are income and wealth levels and population trends, as well as the employment and tax base. For more information on economic considerations for local governments, see Fitch Research on "Local Government General Obligation Rating Guidelines," dated May 23, 2000, available on Fitch's web site at www.fitchratings.com.

■ Set-Asides and Pass-Throughs

In some states, a portion of gross incremental tax revenues often must be available for purposes other than debt service. These set-asides can be senior or subordinate to debt service. For example, California's housing set-asides, as described, are subtracted from gross incremental tax revenues, resulting in a net pledge to bondholders, unless at least 20% of TAB proceeds are used for housing purposes. Redevelopment agency expenses also must be met from gross revenues, although debt service obligations may be senior or junior to expenses.

Obligations to share incremental tax revenues with overlapping municipalities, known as pass-throughs, may rank senior or subordinate to debt service. Therefore, any revenue-sharing agreements will be examined to determine their effect on an agency's ability to meet debt service obligations. Even in cases where these payments are junior to debt service, Fitch considers their effect, since failure to make the pass-throughs over a sustained period likely would endanger interlocal relationships and the agency's overall well being.

Agencies and overlapping municipalities often also agree to rebate to developers percentages of increased hotel, sales, and/or property taxes resulting from new projects. These obligations to rebate should be junior to debt service and are most effective when the rebate is suspended following a delinquency by the developer on its property tax obligations. If the source of tax payments is the expected transfer of shared revenues, debt security is enhanced when these moneys are intercepted and pledged to the trustee. Fitch reviews all documents related to revenue sharing, seeking protection for bondholders.

■ Debt Structure

Tax allocation and tax increment debt structures are often complex and vary nationwide. Bonds may be issued directly by the redevelopment agency or through a conduit financing authority. In a conduit structure, a loan or lease agreement is executed between the financing authority and redevelopment agency. For agencies financing multiple projects, it may be permissible to use revenues from one project area to support another. Fitch reviews the legal documents and debt structure to determine default provisions, cross-collateralization from reserves, or project revenues and self-support.

■ Debt Service Coverage and Debt-Related Covenants

To receive an investment-grade Fitch rating, TABs must meet both of the following debt service coverage tests: net incremental tax revenues received during the previous year cover maximum annual debt service at least 1.0x; and projected pledged revenue (i.e. the previous year's revenues adjusted to reflect projects completed and added to the tax rolls during the current year) for the current year at least 1.1x (110% of maximum annual debt service). Fitch also examines the projected coverage ratio during the year when maximum annual debt service occurs. Depending on individual circumstances, higher coverage levels may be necessary to offset specific concerns, such as taxpayer concentration, earthquake, or other natural disaster risk and pending taxpayer appeals. In general, higher historical coverage will result in higher ratings.

When appropriate, other coverage tests will be relevant to the rating process. Fitch applies one or more stress tests, such as the effect of a percentage decline in property values within the project area, to determine viability of the financing during various economic cycles. Stress scenarios will vary depending on the project area-specific strengths and vulnerabilities. A development agency's authority to retain incremental revenues that exceed debt service facilitates development from nondebt sources and is a positive rating factor.

The additional bonds test should measure debt service coverage ratios, including additional bonds being issued by either: net revenues received during the fiscal year preceding issuance; or revenues projected to be received during the current year. In addition to analyzing the terms of an additional bonds test, Fitch will seek to determine whether such issuance will be necessary to implement the development plan.

TABs require debt service reserve funds throughout the life of the bond issue. Generally, the reserve is funded from bond proceeds at the legal limit of the least of: 125% of average annual debt service; 100% of maximum annual debt service; or 10% of bond proceeds. Reserve fund covenants should also provide for replenishment. However, because redevelopment agencies have no power to increase revenues beyond those occurring as a result of increases in assessed value, if a debt service reserve is drawn upon, funds may not be available to replenish it, regardless of replenishment mechanisms incorporated in bond documents. Fitch views a surety bond provided by a highly rated financial institution as an acceptable alternative to a cash-funded reserve.

■ Conclusion

Tax increment revenues are an important source of funding infrastructure improvements that further development in many parts of the U.S. In fact, successfully executed mature redevelopment plans often generate incremental tax revenues greatly exceeding debt service needs. Many such projects have weathered substantial swings in real estate values without jeopardizing bondholder security. However, others have not fared so well, resulting in diminished credit quality.

Fitch's comprehensive analysis of the aforementioned factors determines which redevelopment agency projects have an excellent chance at succeeding and paying off related debt without interruption. In many instances, the aforementioned risk factors can be mitigated through additional covenants and other structural factors. However, in other cases, risks may be too great to enable an investment-grade rating when the debt is sold. Nonetheless, the projects may prove to be successful, with improved credit over time. Fitch's analysis, then, attempts to delineate bond repayment risk, not necessarily overall project success.

Tax Increment and Tax Allocation Bond Suggested Information

Project Area
- Size of project area.
- Land use of project area.
- Economic diversity.
- Growth potential.
- Major taxpayers and employers.
- Location and transportation access.
- Tax collection history.

Redevelopment Plan
- Development agreement.
- Developer experience.
- Pass-throughs and revenue-sharing agreements.

Agency Management and Tax Procedures
- Separate or overlapping staff.
- Reassessment policies.
- Property transfer policies.
- Foreclosure options.
- Administrative costs.

Area Economics
- Retail, commercial, or residential economic base.
- Competition.
- Regional economic conditions.
- Municipal credit factors.

Set-Asides and Pass-Throughs
- Housing.
- Priority of payment.
- Duration of tax collections.
- Dollar limitations on collections.

Debt Structure
- Direct or conduit.
- Loan or lease agreements.
- Variable or fixed rate.
- Amortization schedule.

Debt Service Coverage and Covenants
- Revenue coverage.
- Stress scenarios.
- Additional bonds test.
- Rate covenant.
- Reserve funds.
- Guarantors.
- Equity distribution and tests.

Documentation (as Applicable)
- Agency resolution.
- Development agreement.
- Revenue-sharing agreement.
- Tax collection agreement.
- Trust indenture/resolution.
- Loan/lease agreements.
- Official statement.
- Market study.
- Feasibility study.
- Sample tenant leases.
- Surety or revenue insurance.
- Debt service cash flows.
- Guarantor information.
- Site visit.

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Section 4

Anne Arundel County, Maryland
Policy on
Special Assessment Districts

Anne Arundel County
Policy Guidelines for Approval of the Creation of a Special Taxing District

Anne Arundel County (the "County") has determined that under certain circumstances, the creation of a Special Taxing District ("STD") can further the economic development/quality growth management/redevelopment goals of the County. Of equal importance to the County is that no public monies be at risk. These guidelines are designed to insure that the County goals are met.

1. **Limited to Projects which Advance County's Plans.** The proposed project or purpose for establishing a STD must advance the County's comprehensive plan and provide greater benefit to the ultimate property owners utilizing the proposed facilities.

2. **Description of Project and STD Petition.** The petitioners shall submit for County staff review, prior to petitioning the County Council for action, a plan of the proposed STD. This submission must include as a minimum: a draft of the STD's petition to the County Council, a map of district boundaries and properties served, a general development plan of the district, proposed district infrastructure including probable cost, a preliminary feasibility analysis (showing project phasing, if applicable, and projected land absorption with the district), a schedule of proposed STD financings and their purpose, a discussion of the STD's proposed financing structure and how debt service is paid, the methodology for determining special assessments within the district, and a general discussion of the developers and/or property owners like that found in an Offering Memorandum. The petitioner shall respond to and incorporate changes to the draft petition requested by staff. Failure to incorporate changes will result in a staff recommendation against the creation of the STD.

   An application fee of $1,000 is payable at the time the petition is submitted. If the petition results in the creation of a STD, an additional $9,000 administrative fee is due.

3. **Consistency with County Planning Documents.** The petitioner must demonstrate that the project or purpose for establishing the STD is consistent with the Comprehensive Plan, Zoning Ordinance, and if applicable, the Capital Improvements Program.
4. **Impact on County Bond Rating.** The STD, either individually or when considered in aggregate with previously approved STD's, shall not have a negative impact on the County's debt capacity or credit rating. Total aggregate outstanding debt of all STD's not serving as a credit enhancement for a tax increment district, shall not exceed 0.5% of the total assessed value of taxable property within the County; nor represent more than 15% of the outstanding tax supported debt. The debt service on STD financing should represent no more than 0.75% of the total of general fund operating revenue and STD

revenue. Maturities of tax increment debt shall be limited to no more than 30 years and the average life of any individual issue shall be no longer than 75% of the longest maturity, or 60% of the average life of the assets being financed based on engineering estimates.

It is the intent of the County that this debt be self-supporting. Debt is deemed self supporting when sufficient revenues generated for at least three consecutive years to pay all of the required debt payments, and during those three years the taxable assessable base would have to have a stable or growing and varied base to produce the revenues. While a debt issue is deemed self-supporting, it shall not be considered in determining the appropriate financial ratios under these guidelines.

The County's total established debt ratios for general county obligations, tax increment obligations, and special taxing district obligations are as follows:

- **Debt Service to Revenues:** 10.00%
- **Debt to Estimated Full Value:** 1.75%
- **Debt per Capita:** $1,200
- **Debt to Personal Income:** 3.50%
- **Special District Debt as % of Total:** 15.00%

5. **Due Diligence.** A due diligence investigation performed by the County or its agents must confirm information regarding the reputation of the developers, property owners, and/or underwriting team, and the adequacy of the developer's or property owner's financial resources to sustain the project's proposed financing.

6. **Project Review and Analysis.** A financial and land use assessment performed by the County or its agents must demonstrate that the STD's proposed development and business plan is sound, and the proposed project or purpose for establishing a STD is economically feasible and has a high likelihood of success. The analysis must confirm why establishing a STD is superior to other financing mechanisms from a public interest perspective.
7. **Petitioner to Pay County Costs.** The petitioner shall agree in writing in advance through a letter of intent to cover the County's costs for all review and analysis and shall provide in the letter of intent a suitable guaranty for the payment of these costs. The County's estimated costs shall be itemized to show anticipated engineering, legal, consultant and other fees.

8. **Agreements.** The County will require of the petitioner submission of the petition to the County Council, to provide the following information:

   - The business plan of the STD;
   - The level, quality and type of public facilities and/or infrastructure to be included;
   - Protections for the benefit of the County with respect to repayment of debt, incorporation, and annexation;
   - Protections for the benefit of individual lot owners within the STD's boundaries with respect to foreclosure and other collection actions should their respective assessment be paid or is current; and
   - That, if the STD requests the County to levy a special tax on its property owners, the STD will pay the County for the costs to levy and collect the special tax and any other ongoing administrative costs of the County.

9. **Credit Requirements.** The debt obligations are issued by the STD to finance or refinance infrastructure of the project:

   a. The STD's outstanding debt obligations as compared to the appraised value of property or adjusted appraised value if partial development has occurred within STD boundaries as if the infrastructure being financed was in-place shall not exceed 33 percent at the time the bonds are issued, and shall not exceed 10 percent once the development is complete, based on reasonable projections.

   b. The STD shall acquire a credit enhancement device acceptable to the County sufficient to guarantee payment of the debt service in the event of default until the STD's outstanding debt obligations, as compared to its estimated taxable assessed value, is estimated to not exceed 10 percent; or limit its debt obligations to minimum $100,000 denominations, and the debt is sold only to qualified or accredited investors.

10. **Requirement for Approved Financing Plan.** The ordinance creating the STD shall include a provision requiring the STD to submit a financing plan to the County for approval by the County Executive prior to the issuance of any STD obligations. Such financing plan shall include details specific to the financing proposed to be undertaken, including, but not limited to more complete and detailed information of those applicable items required under Paragraph 2 above.

11. **No Liability to County.** The project must pose no direct or indirect liability to the County, and the developer and/or STD must provide the type and level of surety acceptable to the County to protect the County from actions or inactions of the STD as specified in the letter of intent at time of petition. All documents relating to the project shall reflect the fact that the County has no financial liability for present or future improvements connected with the project whether or not contemplated by the ordinance creating the STD or as that ordinance may be amended.

12. **Development Agreement.** Covenants acceptable to the County shall be set forth in a development or acquisition agreement executed in connection with the issuance of the debt which among other things, will incorporate the salient commitments of the STD development proposed.

13. **Annual Review.** These guidelines shall be reviewed at least annually, and changes to the guidelines proposed, if necessary, beginning in 1999, in conjunction with the review by the County.

Section 5

Prince William County, Virginia Policy for Approval of the Creation of a Community Development Authority

Prince William County
Policy Guidelines for Approval of the Creation of a Community Development Authority
December, 1998

The Board of County Supervisors (the "Board") has determined that under certain circumstances, the creation of a Community Development Authority ("CDA") can further the economic development/quality growth goals of the County. Of equal importance to the Board is that no public monies be at risk. These guidelines are designed to insure that these Board goals are met.

1. **Limited to Projects which Advance Economic Development.** The proposed project or purpose for establishing a CDA must advance the County's economic development/quality growth strategic goal as outlined in its Strategic Plan.

2. **Description of Project and CDA Petition.** The petitioners shall submit for County staff review, prior to petitioning the Board of County Supervisors for action, a plan of the proposed CDA. This submission must include as a minimum: a draft of the CDA's petition to the Board of County Supervisor's, a map of district boundaries and properties served, a general development plan of the district, proposed district infrastructure including probable cost, a preliminary feasibility analysis (showing project phasing, if applicable, and projected land absorption within the district), a schedule of proposed CDA financings and their purpose, a discussion of the CDA's proposed financing structure and how debt service is paid, the methodology for determining special assessments within the district, and a general discussion of the developers and/or property owners like that found in an Offering Memorandum. The petitioner shall respond to and incorporate changes to the draft petition requested by staff. Failure to incorporate changes will result in a staff recommendation against the creation of the CDA.

3. **Consistency with County Planning Documents.** The petitioner must demonstrate that the project or purpose for establishing the CDA is consistent with the Comprehensive Plan, Zoning Ordinance, and if applicable, the Capital Improvements Program.

4. **Impact on County Bond Rating.** The CDA, either individually or when considered in aggregate with previously approved CDA's, shall not have a negative impact on the County's debt capacity or credit rating. Total outstanding overlapping debt within Prince William County, including the aggregate outstanding debt of all CDA's, shall not exceed ¾% of the total assessed value of taxable property within the County.

5. **Due Diligence.** A due diligence investigation performed by the County or its agents must confirm information regarding the reputation of the developers, property owners, and/or underwriting team, and the adequacy of the developer's or property owner's financial resources to sustain the project's proposed financing.

6. **Project Review and Analysis.** A financial and land use assessment performed by the County or its agents must demonstrate that the CDA's proposed development and business plan is sound, and the proposed project or purpose for establishing a CDA is economically feasible and has a high likelihood of success. The analysis must confirm why establishing a CDA is superior to other financing mechanisms from a public interest perspective.

7. **Petitioner to Pay County Costs.** The petitioner shall deposit in advance funds sufficient to cover the County's costs (including staff time) for all review and analysis. The County's estimated costs shall be itemized to show anticipated engineering, legal, consultant and other fees.

8. **Agreements.** The County will require the petitioner to enter into a Memorandum of Understanding with the County setting forth, as a minimum, the following:

   a. The business plan of the CDA.
   b. The level, quality and type of public facilities and/or infrastructure to be included.
   c. Protections for the benefit of the County with respect to repayment of debt, incorporation, and annexation.
   d. Protections for the benefit of individual lot owners within the CDA's boundaries with respect to foreclosure and other collection actions should their respective assessment be paid or is current.
   e. That, if the CDA requests the County to levy a special tax on its property owners, the CDA will pay the County for the costs to levy and collect the special tax and any other ongoing administrative costs of the County.

9. **Credit Requirements.** If debt or lease obligations are issued by the CDA to finance or refinance infrastructure of the project:

   a. The CDA's outstanding debt or lease obligations as compared to the appraised value of property within CDA boundaries as if the infrastructure being financed was in-place shall not exceed 33 percent at the time the bonds are issued, and shall not exceed 10 percent once the development is complete.
   b. The CDA shall acquire a credit enhancement device acceptable to the County sufficient to guarantee payment of lease payments or debt service in the event of default until the CDA's outstanding debt or lease obligations, as compared to its estimated taxable assessed value, is estimated to not exceed 10 percent; or limit its obligations to minimum $100,000 denominations.

10. **Certification of Information in Offering Documents.** The ordinance creating the CDA shall include a requirement that the CDA shall not issue bonds or other obligations until the County receives appropriate certifications that all information contained in any offering memorandum or other financial documentation that will be made available to potential investors in connection with the sale of bonds or other obligations is accurate, complete and in compliance with securities laws, and that the County has indicated written satisfaction with this certification.

11. **No Liability to County.** The project must pose no direct or indirect liability to the County, and the developer and/or CDA must provide the type and level of surety acceptable to the County to protect the County from actions or inactions of the CDA as specified in the memorandum of understanding. All documents relating to the project shall reflect the fact that the County has no financial liability or for present or future improvements connected with the project whether or not contemplated by the ordinance creating the CDA or as that ordinance may be amended.

12. **Covenants.** Covenants acceptable to the County shall be attached to the property subject to the CDA, which incorporate the salient commitments of the CDA development proposed, and the public benefits. The County must be listed as a beneficiary of any covenant, which relates to the public benefits to the County from the CDA or requirements under these guidelines and any changes to the covenants must require approval by the County.

13. **Amendments to CDA Ordinances.** No amendments to the ordinance creating the CDA shall dilute either the economic development/quality growth or other public benefits, or the protections to the County contained in the original ordinance.

14. **Annual Review.** These guidelines shall be reviewed at least annually, and changes to the guidelines proposed, if necessary, beginning in 1999, in conjunction with the review of the County's Principles of Sound Financial Management.

Section 6

Hanover County, Virginia Policy on Guidelines for the Creation of a Community Development Authority

DRAFT

Hanover County
Policy Guidelines for the Creation of a
Community Development Authority

The Board of County Supervisors (the "Board") has determined that under certain circumstances, the creation of a Community Development Authority ("CDA") can further the economic development/quality growth goals of the County. Of equal importance to the Board is that no public monies be at risk. These guidelines are designed to insure that these Board goals are met.

1. **Limited to Projects which Advance Economic Development.** The proposed project or purpose for establishing a CDA must advance the County's economic development/quality growth goals and objectives as outlined in its Economic Development Strategic Plan or demonstrate that it has a significant positive net fiscal benefit to the County.

2. **Description of Project and CDA Petition.** The petitioners shall submit for County staff review, before petitioning the Board of Supervisors for action, a plan of the proposed CDA. This submission must include as a minimum: a draft of the CDA's petition to the Board of Supervisors, a map of district boundaries and properties served, a general development plan of the district, proposed district infrastructure including probable cost, a preliminary feasibility analysis (showing project phasing, if applicable, and projected land absorption within the district), a schedule of proposed CDA financings and their purpose, a discussion of the CDA's proposed financing structure and how debt service is paid, the methodology for determining special assessments within the district, and a general discussion of the developers and/or property owners like that found in an Offering Memorandum.

3. **Consistency with County Planning Documents.** The petitioner must demonstrate that the project or purpose for establishing the CDA is consistent with the Comprehensive Plan, Zoning Ordinance, the Economic Development Strategic Plan, and the Capital Improvements Program, if applicable.

4. **Impact on County Bond Rating.** The CDA, either individually, or when considered in aggregate with previously approved CDA's, shall not have an adverse affect on the County's debt capacity or credit rating. Total outstanding overlapping debt within Hanover County, including the

aggregate outstanding debt of all CDA's shall not exceed one percent of the total assessed value of taxable property within the County.

5. **Project Review and Analysis.** A financial and land use assessment performed by the County or its agents must demonstrate that the CDA's proposed development and business plan is sound, and the proposed project or purpose for establishing a CDA is economically feasible and has a high likelihood of success. The analysis must confirm why establishing a CDA is preferred to other financing mechanisms from a public interest perspective.

6. **Petitioner to Pay County Costs.** The petitioner shall deposit in advance or reimburse funds sufficient to cover the County's costs for all review and analysis, including any required due diligence. The County's estimated costs shall be itemized to show anticipated engineering, legal, financial, consultant and other fees.

7. **Agreements.** The county will require the petitioner to enter into a Memorandum of Understanding with the County setting forth, as a minimum, the following:

   - The business plan of the CDA.
   - The level, quality, and type of public facilities and/or infrastructure to be included.
   - Protections for the benefit of the County with respect to repayment of debt, incorporation, and annexation.
   - Protection for the benefit of individual lot owners within the CDA's boundaries with respect to foreclosure and other collection actions should their respective assessment be paid or is current.
   - That, if the CDA requests the County to levy a special tax on its property owners, the CDA will pay the County 100 percent of the cost to levy and collect the special tax and any other ongoing administration costs of the County.

8. **Credit Requirements.** If debt or lease obligations are issued by the CDA to finance or refinance infrastructure of the project:

   - The CDA's outstanding debt or lease obligations as compared to the appraised value of property within CDA boundaries as if the infrastructure being financed was in-place shall not exceed 40 percent a the time the bonds are issued, and shall not exceed 10 percent once the development is complete.

9. **Certification of Information in Offering Documents.** The ordinance creating the CDA shall include a requirement that the CDA shall not issue bonds or other obligations until the County receives appropriate

certifications that all information contained in any offering memorandum or other financial documentation that will be made available to potential investors in connection with the sale of bonds or other obligations is accurate, complete, and in compliance with securities laws, and that the County has indicated written satisfaction with this certification.

10. **No liability to County.** The project must pose no direct liability to the County, and the developer and/or CDA must provide the type and level of surety acceptable to the County to protect the County from actions or inactions of the CDA as specified in the memorandum of understanding. All documents relating to the project shall reflect the fact that the County has no financial liability or for present or future improvements connected with the project whether or not contemplated by the ordinance creating the CDA or as that ordinance may be amended.

11. **Covenants.** Covenants acceptable to the County shall be attached to the property subject to the CDA, which incorporate the salient commitments of the CDA development proposed, and the public benefits. The County must be listed as a beneficiary of any covenant that relates to the public benefits to the County from the CDA or requirements under these guidelines and any changes to the covenants must require approval by the County.

12. **Amendments to CDA Ordinances.** No amendment to the ordinance creating the CDA shall dilute either the economic development/quality growth or other public benefits, or the protections to the County contained in the original ordinance.

13. **Annual Review.** These guidelines shall be reviewed at least annually and changes to the guidelines proposed if necessary.

Section 7

Henrico County, Virginia Policy on Economic Development Incentives

Henrico County, Virginia
Criteria for Economic Development Incentives

1. **Performance Based.** Incentives should be performance based and funded only with actual incremental County revenue generated by new projects.

2. **Project Size.** Projects, which will increase the tax base significantly, (including those which represent at least one percent of the tax base) are appropriate for consideration.

3. **Revenue Allocation.** More revenue should flow to the County over time than to funding incentives. The project will then generate funding capacity for other County projects in an equal or greater amount using resources which otherwise may have been unavailable.

4. **Incentive Limits.** Incentives generally should not exceed the incremental County revenue expected to be generated in the five years following completion of the project, or the long-term equivalent thereof.

5. **Debt Limits.** Construction funded from incentive-related debt (whether direct debt or over-lapping debt), if any, should not exceed 10% of the value of the project. It is desirable to avoid any direct debt of the County amortized over more than 5 years. Overlapping debt should not amortize more slowly than a 15-year level debt service structure.

6. **Credit Rating.** Incentives and related financial arrangements will not adversely impact the credit rating of the County.

7. **Impact on Services.** The project will not have a substantial impact on County services.